Corporate governance and corporate social responsibility

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Chapter 5. Conclusion

Corporate governance plays a crucial role in inducing firms to internalize the welfare of not only shareholders but also non-shareholder stakeholders (Aguilera et al., 2015). Since the turn of the twenty-first century, the stakeholder approach to corporate governance has also become more prominent, resulting in regulatory changes, increased media attention, shift in investor preferences, and the rise of socially responsible governance mechanisms within firms (Hambrick et al., 2008; Walls et al., 2012). The common goal of the three empirical chapters in this dissertation is to investigate the effectiveness of different corporate governance mechanisms in fostering socially responsible firm practices. In particular, these chapters relate to different aspects of the relationship between corporate governance and CSR. Chapter 2 focuses on the symbolic adoption of socially responsible governance mechanisms by firms. Chapter 3 and 4 explore how institutions matter by examining the corporate governance—CSR relationship across different temporal and geographical contexts respectively.

In the next sections, I will briefly summarize the main findings of the empirical chapters, discuss their contribution to the literature, and propose directions for future research.

5.1 Summary of the Main Findings

Chapter 2 investigates the symbolic adoption of socially responsible mechanisms, focusing on the presence of NGO directors on boards. As CSR becomes more prominent in the corporate world, firms are facing tight governmental regulations, increased media attention, and strong social activism for advancing CSR. Resource dependence theory indicates that NGO directors can help firms address these external pressures in two ways: (1) improving CSR decision by offering CSR related expertise and connections and (2) providing legitimacy by signaling the firms' social awareness and credibility. By examining what type of firms are more likely to have NGO directors on their boards and whether the presence of NGO directors enhances CSR, Chapter 2 shows that firms have NGO directors on their boards merely for their symbolic value rather than for enhancing CSR performance. Specifically, using a sample of 157 firms listed on the S&P 500 index between 2012-2014, Chapter 2 reports that firms with lower CSR performance in the past than their peers are more likely to have NGO directors on their boards, whereas the presence of NGO directors does not increase CSR.

Chapter 3 highlights the role of temporal context in shaping how institutional investors affect executive-to-worker pay dispersion by replicating and extending Connelly et al. (2016). The original study, based on data from a sample of 1,500 S&P firms between 1996-2006, reports that transient institutional investors positively affect executive-to-worker pay dispersion, while dedicated institutional investors negatively affect executive-to-worker pay dispersion. With an extended dataset, which includes information for 1996-2017, Chapter 3 demonstrates that in contrast to Connelly et al. (2016), the impact of transient institutional investors on executive-to-worker pay dispersion turns negative after 2006. Moreover, quasi-indexers, which make up the largest group of institutional investors but are ignored in the original study, also have changed their behavior over time. Whereas quasi-indexers do not affect executive-to-worker pay dispersion during 1996-2006, they become a key force in reducing executive-to-worker pay dispersion during 2007-2017. These findings provide a qualification of institutional theory by showing that transient institutional investors and quasi-indexers have become more sensitive to executive-to-worker pay dispersion as this issue grows to be more salient since the 2007-2008 financial crisis.

Chapter 4 discusses how institutions matter by considering the geographical diversity of the corporate governance—CSR relationship. Focusing on the issue of board gender diversity, it provides insights for the effectiveness of firm-level BGDP in increasing women on boards across countries. It emphasizes that the extent to which BGDP is effective in bringing more women to corporate boards depends on the institutional environment in which the firm operates. The results presented in Chapter 4, which are based on an analysis of 23,476 firm-year observations from 33 countries over the period 2003–2014, reveal a marginal positive relationship between BGDP and women on boards in general and that institutions matter. Specifically, BGDP is less effective in increasing women on boards in countries with strong gender role bias or a tight supply of female directors. Moreover, board gender diversity provisions in a country's corporate governance codes act as substitutes for BGDP, while gender quotas neither amplify nor weaken the relationship between BGDP and women on boards.

5.2 Theoretical Implications

The three empirical studies in this dissertation offer two theoretical implications for studying the relationship between corporate governance and CSR. The first theoretical implication concerns the relationship between board composition and CSR. Resource dependence theory outlines four benefits directors can bring to the firm, namely advice and counsel, channels for communicating information with external organizations, commitment and support from important elements outside the firm, and legitimacy (Pfeffer & Salancik, 1978). Previous studies frequently emphasize the former three benefits, based on which directors with CSR-related expertise and/or connections are expected to improve CSR (Bai, 2013; Dixon-Fowler, Ellstrand, & Johnson, 2017; Hillman et al., 2001; Johnson & Greening, 1999; Jones & Goldberg, 1982; Kock et al., 2012; Luoma & Goodstein, 1999; Mallin & Michelon, 2011). Chapter 2 extends this line of research by considering the legitimacy role of NGO directors. By showing that NGO directors are more prevalent in firms with poor CSR records and that the presence of NGO directors does not increase CSR, Chapter 2 suggests that firms may have

NGO directors only for improving legitimacy rather than to utilize their knowledge or connections.

The second theoretical implication relates to how institutions matter. Aguilera et al. (2010: 290) state that "most scholars interested in cross-nationally comparative corporate governance now agree that 'institutions matter' for corporate governance, but how they matter remains a hotly contested question". Chapter 3 and 4 provide insights into how institutions matter by examining the role of the institutional environment in shaping the relationship between firm-level governance mechanisms and CSR (Aguilera et al., 2015).

Institutions determine the effect of corporate governance mechanisms on CSR by influencing the preferences of corporate governance actors. As demonstrated in Chapter 3, transient institutional investors and quasi-indexers become active in reducing the executive-to-worker pay dispersion of their portfolio firms since the 2007-2008 financial crisis, when the large pay gap between top executives and average workers started to provoke public outcry and government actions. Chapter 4 shows that cultural gender role bias weakens the effectiveness of BGDP in promoting women on boards. We argue that in countries with strong gender role bias, firms may experience more resistance from their employees and shareholders while implementing BGDP and firm deviations from their BGDP are less likely to less likely to be questioned by the public.

Institutions also shape the extent to which a corporate governance mechanism can achieve the desired results by creating a facilitating or constraining environment. For example, one important finding of Chapter 4 is that BGDP becomes more effective in increasing women on boards when the labor market for female directors is expanding because it becomes easier for firms to find appropriate female director candidates. Moreover, the finding of Chapter 4 regarding gender role bias indicates that a culture of strong gender role bias constrains the effectiveness of BGDP by creating more barriers to the implementation of BGDP.

Finally, institutional level governance mechanisms may act as complements or substitutes for their firm-level counterparts to affect CSR. Previous research has investigated the effect of the bundle of corporate governance mechanisms at either the institutional level (Iannotta et al., 2016) or the firm level (Oh et al., 2018), providing evidence for complementary effect at the institutional level and substitution effect at the firm level. Chapter 4 adds to this stream of research by looking at governance mechanisms across levels. Theoretically, one may expect institutional-level regulatory prescriptions for board gender diversity (i.e., quota or gender-specific provisions in corporate governance codes) to serve as both complements and substitutes for firm-level BGDP because these regulatory prescriptions support the goals of BGDP from a higher authority on the one hand, and make the added value of BGDP less obvious on the other hand. Empirically, Chapter 4 reveals that institutional-level regulatory prescriptions and firm-level policies for board gender diversity mainly act as substitutes. However, whether such a substitution effect exists depends on the nature of the regulatory prescriptions. Whereas gender-specific provisions in corporate governance codes and BGDP can substitute each other, gender quotas and BGDP are not substitutes. We propose this is because quotas are less flexible than corporate governance codes.

5.3 Practical Implications

This dissertation offers several practical implications as well. First, Chapter 2 indicates that firms that are unwilling to make CSR investments may instead change board compositions to signal their awareness of CSR issues and appear to be taking right steps to address these issues. Such symbolic actions are more likely if firms perform bad in terms of CSR strengths.

By understanding which firms are more likely to have NGO directors on their boards for symbolic reasons, policymakers, investors, and NGOs can better evaluate firms' CSR commitment and encourage them to make full use of NGO directors' expertise.

Second, Chapter 3 demonstrates that quasi-indexers are responsive to institutional pressures, which may be attribute to the fact that their universal and long-term ownership makes them to be exposed to risks of corporate negative externalities inevitably (Chen, Dong, & Lin, 2019). As quasi-indexers growing in their market shares and influence over firm decisions, policymakers and the media may be more powerful in fostering socially responsible firm practices via issue framing. In addition, as quasi-indexers have increasingly become the largest shareholders of US firms, managers may be more proactive in observing changes in public policies and norms in the capital market. In this way, managers can better predict and react to their investors' demands and voting behavior.

Third, although policymakers have advocated BGDP as a remedy for the enduring gender inequality on corporate boards, Chapter 4 shows that promoting firm adoption of BGDP itself may not be sufficient to substantively increase women on boards. BGDP may fail in countries with strong gender role bias because of increased resistance from the firm's managers and investors. It can also fail in countries with limited supply of female directors, which makes it difficult for firms to find appropriate female director candidates. To enhance the effectiveness of BGDP, policymakers should engage in public discourse by framing and making sense of the board gender diversity issue to enhance the pragmatic, moral, and cognitive legitimacy for improving women on boards. Moreover, women's organizations and executive search corporations can help improve the effectiveness of BGDP by creating a database of or connecting firms to potential female director candidates.

5.4 Limitations and Directions for Future Research

This dissertation includes three empirical studies on the relationship between corporate governance and CSR. The three empirical studies tackle different aspects of the focal relationship to offer insights into symbolic socially responsible governance structures and how institutions shape the effect of corporate governance mechanisms on CSR. Despite the contributions made, our studies have some limitations that need to be addressed. This section reflects limitations and future research directions that are more generally applicable to all the three empirical studies in addition to those discussed each empirical chapter.

5.4.1 Look Beyond Board Demographic Characteristics

Chapter 2 and 4 focus on board demographic characteristics such as professional background and gender, while they ignore board behavioral structures and processes. Behavioral structures deal with the power dynamics within boards, emphasizing the similarity between boards and other social entities in terms of status and power gradations (Hambrick et al., 2008; Veltrop, Molleman, Hooghiemstra, & van Ees, 2017; Westphal & Zajac, 2013). Power differentials within boards have substantial influence on board decisions. For instance, despite often being appointed for symbolic reasons, NGO directors may improve CSR if their status on boards increases. Behavioral processes question the rationality of board decision making, highlighting that directors, just like any other humans, are influenced by their own preferences and bias (Hambrick et al., 2008; Hillman, Nicholson, & Shropshire, 2008; Westphal & Zajac, 2013). As a result, focusing on increasing the percentage of female directors alone may not benefit firm performance because these female directors' voices are often overlooked in traditionally male-dominant boards. We thus call for more behavioral oriented studies to open the black box of board decision making process. For example, how power differentials within boards moderate the relationship between board demographic attributes and decisions.

Another example is how to foster an inclusive and open discussion culture within boardrooms, which allows the benefits of diversity to be realized. Methodologically, archival data is not appropriate for conducting behavioral oriented studies anymore. Behavioral oriented studies rely on surveys, interviews, or the video-based psychometric approach to measure individual directors' psychological attributes, mental capabilities, status, and behavioral style. This requires efforts from researchers to access boards.

5.4.2 Meso-Level Institutions

Chapter 3 and 4 explore how the relationship between firm-level governance mechanisms and CSR is conditioned on country-level institutions. Yet, industries, states, and cities as the contexts in which a firm is embedded may also moderate the effect of corporate governance mechanisms on CSR. For example, BGDP may be more effective in increasing women on boards in the information technology industry, which is exposed to greater global competition and thus stronger pressure to comply with the global norms of board gender diversity (Khanna & Palepu, 2004). Firms in environmentally sensitive industries may be more likely to have NGO directors on their boards to avoid legitimacy risk since they are subject to heightened public scrutiny (Slawinski & Bansal, 2015). Institutional investors may be keener to reduce executive-to-worker pay dispersion of firms from the highly regulated financial industry, where the legislative risk of large executive-to-worker pay dispersion is higher (Krainer, 2012).

Researchers should also pay attention to a firm's state/provincial context, especially for studying large countries such as the US, Canada, and China. Different states may vary in their stakeholder orientation (Flammer, 2013), institutional development (Luo, Wang, & Zhang, 2017), and political ideology (Gupta & Wowak, 2017). These elements can affect the corporate governance—CSR relationship by shaping governance actors' preferences for CSR and creating a facilitating or constraining environment.

City location is another underestimated factor in our studies and in management research in general. As proximity facilitates the flow of information, resource, values, and norms, city location may have a significant effect on corporate governance and CSR (Hoi, Wu, & Zhang, 2018; Husted, Jamali, & Saffar, 2016; Marquis, Glynn, & Davis, 2007). Different from other levels of institutions, the focus here is shifted to the actions of co-located organizations. As such, a firm is less likely to commit symbolic adoption of socially responsible governance structures if other local corporations headquartered in the same city tend to make substantive CSR investment. BGDP may be more successful if the firm locates in major cities where the sources for identifying appropriate female director candidates are more abundant. In sum, it would be fruitful for future research to investigate the role of meso-level institutions (including but not limited to industry, state, and city) in corporate governance and CSR. A greater awareness of the effect of meso-level institutions also enhances our understanding the nuance between corporate governance and CSR.

5.5 Concluding Remarks

The purpose of this dissertation is to examine the effectiveness of different corporate governance mechanisms in enhancing CSR. Findings from this dissertation highlight two issues in the intersection between corporate governance and CSR: symbolic adoption of socially responsible governance mechanisms and the role of institutions. Chapter 2 demonstrates that NGO directors mainly play a symbolic role in CSR and that firms with poor CSR records, especially in terms of CSR strengths, are more likely to have NGO directors on their boards for symbolic reasons. Chapter 3 and 4 illustrate that institutions manifest their influence on the relationship between corporate governance and CSR over time and across space, by changing governance actors' preferences, creating a facilitating or constraining environment, and complementing or substituting for their firm-level counterparts. Specifically, Chapter 3 reports that transient institutional investors and quasi-indexers have become more active in reducing executive-to-worker pay dispersion as public outcry and government regulation on this issue intensified since the 2007-2008 financial crisis. Chapter 4 shows that the positive effect of BGDP in increasing women on boards is weakened in countries with gender-specific provisions in their corporate governance codes, with a stronger gender role bias, and with a tight supply of female directors. As a stakeholder model of corporate governance become more prominent in the corporate world, this dissertation provides important insights for managers and policymakers into what governance mechanisms work (or do not work), how they work, and when they work to foster socially responsible firm practices.